



Transfer pricing controversy management

CPA Jared Maranga
jmaranga@gmail.com

Agenda



- Transfer pricing controversy facts and trends
- Assessing Transfer pricing risk
- Causes of transfer pricing controversy
- Managing Transfer pricing audit process
- Managing Transfer pricing controversy
- Transfer pricing controversy tools
- Mitigating transfer pricing risks
- Q&A

TP Controversy Facts



- ❖ TP is not an exact science, subjective interpretation
- ❖ TP practice vary widely across many jurisdictions
- ❖ Transfer pricing cases are fact-intensive & complex- Does this warrant room for making a mistake?
- ❖ TP and TP audits may take longer period compared to other audits
- ❖ There is no defined approach in dealing with TP Controversy.

TP Controversy trends



- ❖ Increased integration of economies and national markets - threat to tax systems
- ❖ Trade amongst the MNCs accounting for over 60% of the global trade.
- ❖ Increased adoption of transfer pricing legislation and exchange of information in place, and more and more aggressively enforce that legislation
- ❖ Increase in demand for domestic resource mobilisation for many countries
- ❖ Increased in capacity and resources– Revenue authority officers
- ❖ Controversy is on the rise, with negative consequences for governments and taxpayers alike

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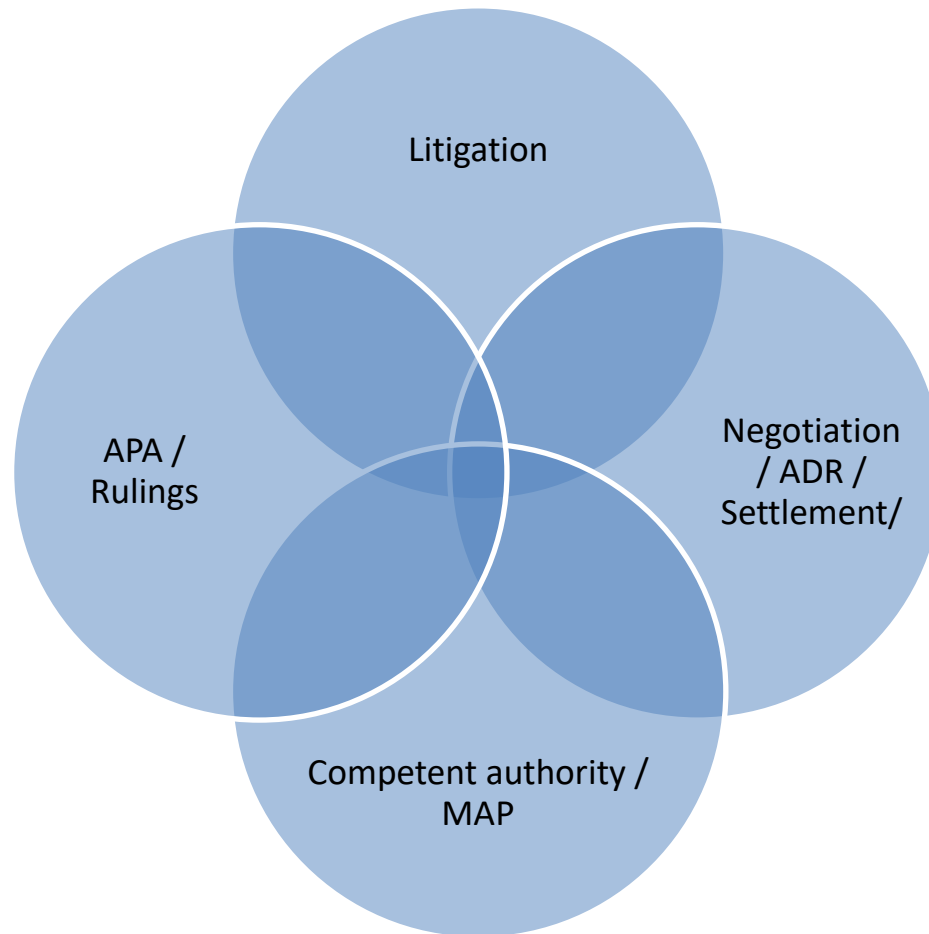
Controversy in practice



- ❖ Transfer Pricing Controversy in practice makes up a significant part of Tax Controversy.
- ❖ Why TP controversy?
 - ❖ Different standards used for ALP (hard to manage globally)
 - ❖ Vaguely worded TP rules
 - ❖ Procedural differences (burden of proof/level of documentation)
 - ❖ TP corrections are generally an easy way to drive tax proceeds.
 - ❖ Innovative ADR mechanisms available

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Controversy Management tools



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Causes of TP controversies



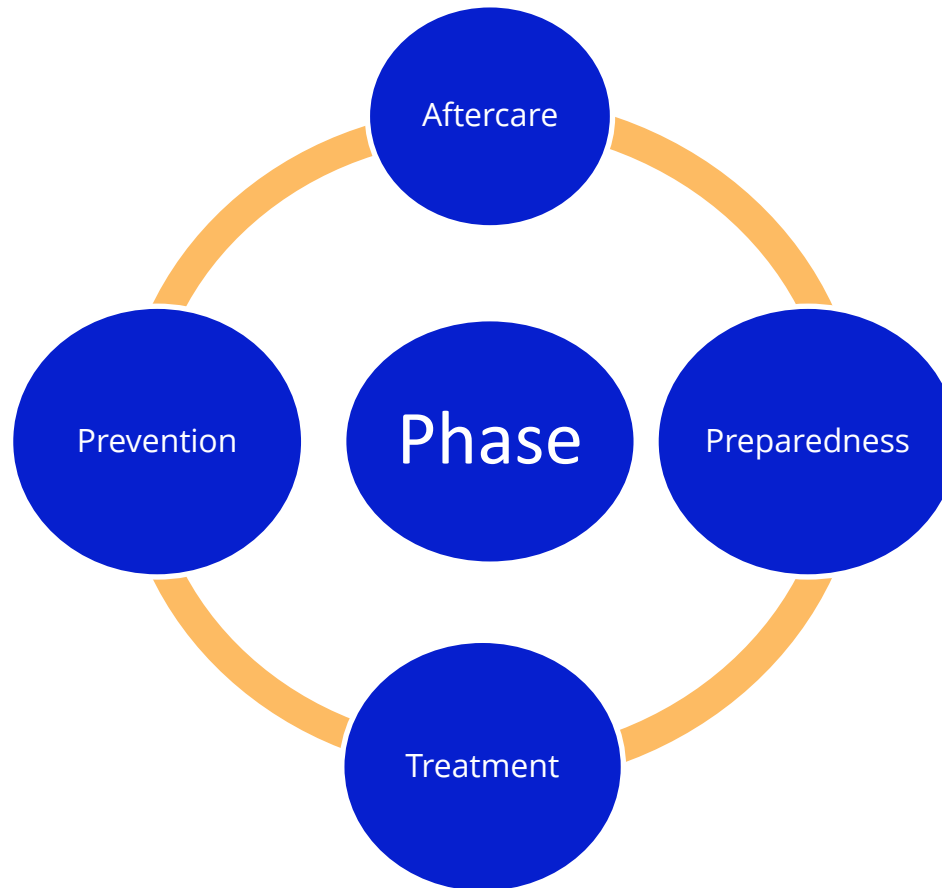
- ❖ Partial or non coverage of the controlled transactions;
- ❖ Failure to document search strategy where databases are used;
- ❖ Failure to undertake proper qualitative analysis on comparables;
- ❖ Incorrect application of the selected TP methods e.g. wrong PLI, wrong characterisation;
- ❖ Existing differences between facts in the transfer pricing document and the actual business operations;

Causes of TP controversies



- ❖ Failure to make comparability adjustments such as:
 - ❖ Economic circumstance adjustments;
 - ❖ Geographical market differences;
 - ❖ Characteristics of property or services;
 - ❖ Functional analysis i.e. functions, risks and assets; and
 - ❖ Contractual terms like the terms of trade.

TP controversy Management phases



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TP controversy phases



Prevention Phase:

- ❖ Mechanisms that can be adopted at planning stage:
 - ❖ Consider what defense items can be employed and implemented to mitigate tax controversy exposure down the line
 - ❖ Consider how to reflect items from a compliance and reporting perspective
 - ❖ Considering using robust documentation, language used , list of evidence required
 - ❖ Consider obtaining a ruling or an opinion

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TP controversy phases



Preparedness Phase:

- ❖ Outcome of self assessment and something is not right. – late filing, tax compliance check, amnesty period or receipt of intention to audit.
 - ❖ What is the burden of proof allocation?
 - ❖ What remedial actions exist (amended return, apply voluntary disclose or play the audit lottery?)
 - ❖ Collecting the relevant facts and weighing their importance is of key importance during this phase
 - ❖ Deciding how to manage the (possible) dispute process

TP controversy phases



Treatment Phase:

- ❖ When an adjustment is proposed, or discussions on the adjustment are perhaps still ongoing, there are several issues to consider:
 - ❖ How can you narrow the scope of the matter in dispute?
 - ❖ What remedies are available?
 - ❖ What are the consequences of the dispute resolution/dispute management tools that are available?

TP controversy phases



Treatment Phase:

- ❖ What option is most desirable considering relevant stakeholders and recurring consequences of that route and resolution option?
- ❖ How to prepare an objection or appeal?
- ❖ Are there any alternative dispute resolution options (mediation/arbitration), how to avoid double taxation?

TP controversy phases



After care Phase:

- ❖ Implementation of the dispute outcome, what are the consequences of the dispute outcome for tax reporting requirements and what other taxes may or may be triggered
 - ❖ Was the issue in dispute a one-time issue or recurring? If recurring, is remedial action taken as regards later years?
 - ❖ Can internal procedures be amended/improved to help avoid having the issue resurface?
 - ❖ Can a closing agreement be entered into on later open years with the same issue or perhaps an Advance Pricing Agreement?

TP controversy phases



After care Phase:

- ❖ How is double tax relief obtained after settlement of the issue or after having received a court judgment on the issue?
- ❖ Can the issue be finalized/ agreement implemented without triggering indirect tax consequences?

Consequences of TP Controversy



- ❖ Getting tax controversy wrong can result in severe financial penalties and sizeable interest payments
- ❖ Investor perception has changed; tax “shocks” are punished very heavily
- ❖ Tax compliance is costing organizations more
- ❖ Tax is becoming a corporate governance issue: company officers are becoming personally responsible for the tax numbers
- ❖ Companies that continue to have multiple tax controversies are at risk of creating negative perceptions with tax authorities and the public at large
- ❖ The public is increasingly seeing taxation as a Corporate Social Responsibility issue
- ❖ Audit in one jurisdiction may trigger audit in the other countries.

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TP risk assessment



- ❖ Do you have cross border intercompany transactions?
- ❖ Are you in receipt of tax incentives or have IC dealings with tax havens
- ❖ Are the intercompany transactions large or complex?
- ❖ Are there other dealings that are not charged?
- ❖ Do you have secondments of senior management to or from Kenya?
- ❖ Do you have local entities with operating losses for 2 years or more?

TP risk assessment



- ❖ Have you not yet prepared local transfer pricing documentation for the Financial Year in question?
- ❖ Did you submit your corporate income tax return?
- ❖ The key risk is economic double taxation due to a transfer pricing adjustment!

Managing the audit process



- ❖ Make sure you keep control of the process
- ❖ Clear and broad commercial understanding of the business
- ❖ Be clear of audit scope before sharing any information requested.
- ❖ Review your strategy and seek advice;
 - ❖ Is this a matter of principle to be defended at all costs
 - ❖ Is it a matter of comparables with room for negotiation
- ❖ If interviews are requested, ensure your staff are extremely well briefed
- ❖ Ensure all discussions minutes are kept and provided to the tax authority for agreement

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Managing the audit process



- ❖ Solid documentation, well-prepared and substantiated documentation enables you to defend your transfer pricing policies.
- ❖ Be compliant - TP file , file corporate returns, make the necessary disclosures
- ❖ Non aggressive position, aimed at management of tax perceptions by the revenue authorities.
- ❖ If documents are requested ensure you provide copies and keep a copy on file – clearly mark information shared.

Mitigating TP risks



- ❖ Ensure disclosures on tax return are correct and complete
- ❖ Ensure documentation and contracts all align
- ❖ Ensure TP policy is implemented to the letter
- ❖ Ensure TP documentation is up to date
- ❖ Ensure the comparability analysis is robust and supports all the transactions covered
- ❖ Identify any weaknesses and plan to defend these
- ❖ Engage your tax advisors in the documentation and defense process.

Q&A

Next steps

Should you have any questions please let us know

Jared Maranga: jmaranga@gmail.com

Mobile: +254 720 799 410